

## DEPARTMENT OF STATE REVENUE

01-20200404.LOF; 01-20200405.LOF  
01-20200406.LOF; 01-20200407.LOF**Letter of Findings: 01-20200404, 01-20200405, 01-20200406, 01-20200407**  
**Individual Income Tax**  
**For the Years 2016, 2017, and 2018**

**NOTICE:** IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

**HOLDING**

Individuals - partners of an Indiana Business - provided additional documents to demonstrate that Indiana Business was not responsible for additional income tax assessed on income, which was attributable to commercial loans and insurance proceeds of inventory recovery.

**ISSUES****I. Individual Income Tax - Burden of Proof.**

**Authority:** IC § 6-3-1-3.5; IC § 6-8.1-5-1; IC § 6-8.1-5-4; *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014).

Taxpayers protest the imposition of additional income tax.

**II. Tax Administration - Negligence Penalty.**

**Authority:** IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayers protest the imposition of the negligence penalty.

**STATEMENT OF FACTS**

Taxpayers, four (4) partners of an Indiana limited liability company ("LLC"), which files federal (Form 1065) and Indiana (Form IT-65) partnership tax returns. LLC's gain or loss passed through to Taxpayers and Taxpayers reported the income or deducted the loss in their federal and Indiana individual income tax returns.

The Indiana Department of Revenue ("Department") conducted an audit of LLC's business records and tax returns for 2016, 2017, and 2018 ("Tax Years at Issue"). Pursuant to an audit, the Department determined that LLC had additional income. As a result, Taxpayers were assessed additional income tax, interest, and negligence penalty.

Taxpayers protested the proposed assessments and penalty. The Department had a telephonic conference with Taxpayers' representative. This Letter of Findings ensues. Additional facts will be provided, as necessary.

**I. Individual Income Tax - Burden of Proof.****DISCUSSION**

The Department's audit reviewed LLC's business records and tax returns, determining that LLC had additional income. The audit thus assessed Taxpayers additional income tax because the additional income passed through to Taxpayers, LLC's partners.

Taxpayers, to the contrary, contend that the Department's audit erroneously classified LLC's loans and insurance

proceeds for inventory damage as income. Therefore, Taxpayer asserts that the assessment was incorrect.

Indiana mandates that every person who is subject to a listed Indiana tax must keep books and records, including all source documents, "so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks." IC § 6-8.1-5-4(a). "If the [D]epartment reasonably believes that a person has not reported the proper amount of tax due, the [D]epartment shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the [D]epartment." IC § 6-8.1-5-1(b).

In reviewing any protest, all tax assessments are *prima facie* evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). Also, "all statutes are presumptively constitutional." *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 587 (Ind. 2014) (citing *UACC Midwest, Inc. v. Indiana Dep't of State Rev.* 629 N.E.2d 1295, 1299 (Ind. Tax Ct. 1994)). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Caterpillar, Inc.*, 15 N.E.3d at 583.

Pursuant to IC § 6-3-1-3.5, the Indiana income tax rules piggyback on the federal income tax statutes and regulations. Therefore, the federal rules and case law are generally applicable to determine individual partner's tax liability.

In this instance, during the audit process, the Department reviewed LLC's business records and tax returns for the Tax Years at Issue. The audit determined and calculated the total amount of LLC's annual revenue. The audit then calculated the total amount of LLC's loans for each year. After LLC documented its commercial loan clearly, the audit then subtracted those loan amounts from LLC's total annual revenue to determine the amount of additional income for each year.

Taxpayers protested the audit's reclassification of LLC's income concerning (1) commercial loans from LLC's banks and (2) insurance proceeds from LLC's insurance company. Taxpayers explained the following:

\$133,000 of loans appear to be unrecorded in [audit] workpapers, misstating [the] revenue estimate . . . and at least \$172,000 in insurance proceeds that were deposited that were picked up as additional revenues in [audit] report when [Taxpayers] used those proceeds as a reduction in inventory . . . .

Specifically, referencing LLC's bank statements and its general ledger, Taxpayers explained that pursuant to the general business practice of banks, LLC's monthly bank statements were prepared before the last day of the month (or the year). For example, LLC's December bank statement reflected transactions occurred after November 10 and before December 11. Similarly, for the transactions occurred after December 10, they were reflected on January statement of the following year. As such, the audit conclusion that LLC underreported its income was not correct. In addition, Taxpayers stated that the audit understated the amount of LLC's loans because the audit mistakenly reclassified some of the loans as revenue. Taxpayers also claimed that the audit overstated the revenue because the audit mistakenly reclassified insurance proceeds as income. Taxpayers further submitted additional documentation including LLC's bank statements and insurance payments for the property loss in 2017 to support their protest.

Upon review, Taxpayers' supporting documents demonstrated that LLC filed an insurance claim (number 1122969) in June 2017. Subsequently, the insurance company made payments to LLC under that insurance claim. The Department is prepared to agree that insurance payments were to compensate LLC's property loss, not income to LLC. As such, the insurance proceeds in 2017 should be removed from LLC's revenue in a supplemental audit.

Finally, the audit determined that LLC had various loans and did not challenge the substance of the loans. The audit then calculated the total amount of loans which was subsequently subtracted from the total amount of revenue for the purpose of computing additional income. Since the amount of loans is a mathematical calculation, the Department will review and correct numbers in the supplemental audit, as necessary.

## FINDING

Taxpayers' protest is sustained.

### II. Tax Administration - Negligence Penalty.

## DISCUSSION

Taxpayers also protest the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a return for any of the listed taxes;
- (2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
- (3) incurs, upon examination by the department, a deficiency that is due to negligence;
- (4) fails to timely remit any tax held in trust for the state; or
- (5) is required to make a payment by electronic funds transfer (as defined in [IC 4-8.1-2-7](#)), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department . . .

[45 IAC 15-11-2](#)(b) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2](#)(c), in part, as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Upon review, Taxpayers' documentation established reasonable cause as provided under [45 IAC 15-11-2](#)(c) and the Department is prepared to agree that penalty should be abated.

## FINDING

Taxpayers' protest is sustained.

## SUMMARY

For the reasons discussed above, Taxpayers' protest is sustained. The Department will conduct a supplemental audit review and make appropriate adjustments as described in Issue I and Issue II accordingly.

December 15, 2020

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An [html](#) version of this document.